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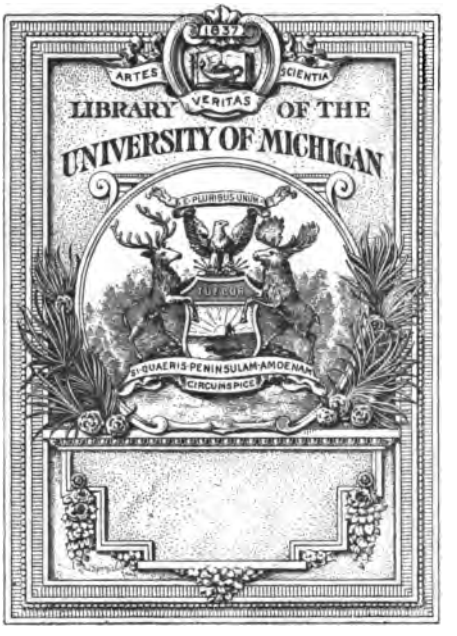
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RAILWAY CAPITALIZATION

By H. T. NEWCOMB

OF THE BAR OF THE DISTRICT OF COLUMBIA.

Author of "Railway Economics," "The Postal Deficit," "Some Consequences of the Trust Movement," "Recent Phases of the Labor Problem," "The Federal Courts and the Orders of the Interstate Commerce Commission," "The Facts About Railroad Rates," "The New Interstate Commerce Law," "A Conservative Trust Policy," "Public Ownership and the Wage-Earner," Etc., Etc.

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Contents

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Railway Capitalization

By H. T. Newcomb

IMPORTANCE OF THE SUBJECT

THERE are few subjects relating to the industrial life of the American people upon which so much misinformation is current or concerning which there is such widespread misunderstanding as that of the capitalization of American railways. This is unfortunate for not only is the direct ownership of railway shares and bonds already greatly diffused but they would constitute, if unwise legislation could be avoided, the most stable and satisfactory investment generally open to those whose moderate incomes, as farmers, artisans or clerks, permit only small accumulations. With the assurance against unjust interference which would result from full public comprehension, the existence of such a ready means of investing small savings would at once become the greatest incentive to economy and frugality. It is unfortunate, also, because such misunderstanding is a constant threat against the security afforded by the billions of dollars of railway bonds and the smaller quantity of railway shares that are held in the treasuries of savings banks, life insurance companies, fire insurance companies and bonding and guarantee companies, and on which depend their ability to fulfill their obligations to millions of

American citizens. Further than this, it is unfortunate because it is one of the causes which is depleting the money market of capital seeking investment in railway enterprises, increasing the difficulty of obtaining funds for new construction and for renewals and improvements and bringing about a rise in interest rates that must prove a burden to the industry of the Nation. Misunderstanding has not occurred because the subject is necessarily obscure or attended with difficulty, for it is neither. The Interstate Commerce Commission has published eighteen successive annual volumes of railway statistics, the Census office has devoted volumes and folio pamphlets to the same subject and there are many private publications that are reliable and valuable. Whoever will study the subject with intelligence and without prejudice will, from the materials thus available, be able to reach an accurate conclusion.

AGGREGATE AND AVERAGE PER MILE

The latest statistical report issued by the Interstate Commerce Commission covers the fiscal year which ended with June 30, 1905. At the end of that year the railways of the United States had an aggregate length of 218,101 miles, of which 217,018 miles were covered by reports to the Commission. The total capitalization of the reporting railways on that date was $11,167,105,992 * or at the rate of $51,457 per mile of line.

*The common impression that the total par value of railway capitalization exceeds $13,000,000,000 is founded upon an improper use of statistics supplied by the Interstate Commerce Commission which is fostered by the arrangement of its tables. The total of all capital issues, on June 30, 1905, was $13,805,258,121, but as $2,638,152,129 of this total was held by railway companies as the basis of other issues, the duplication thus arising ought to be deducted. The total given in the text, $11,167,105,992, is the

CAPITALIZATION OF FOREIGN RAILWAYS IS HIGHER

This is a lower average capitalization per mile than that of any country having railway facilities which even approximate the high quality of those traversing the United States. The "Archiv für Eisenbahnwesen" for May and June, 1906, gives the following data concerning the European countries whose railways are comparable with those of the United States:

Country.	Length of line in miles.	Total capitalization.	Average capitalization per mile of line.
Great Britain and Ireland ..	22,147	$5,792,206,000	$261,535
German Empire	33,594	3,334,618,000	99,262
France	27,739	3,370,556,000	121,510
Austria	12,813	1,373,498,000	107,196
Belgium	2,520	399,602,000	158,572
Switzerland	2,536	257,516,000	101,544
Italy	9,962	1,077,902,000	108,212
Spain	2,272	214,200,000	94,278
The Netherlands	1,653	136,612,000	82,645
Russia (not including Finland)	36,683	2,769,844,000	75,508
Total	151,918	$18,726,554,000	$123,268

The aggregate railway mileage of all the countries of Europe, at the dates represented in the publication from which the foregoing table was prepared, was 177,491 miles with a total capitalization of $20,018,418,000, or an average of $112,786 per mile, or more than twice the average in this country. Thus the European railway system, which has less than eighty-two miles for each one hundred miles in the United States, sustains $179.26 of

difference after such deduction. The Interstate Commerce Commission recognizes the validity of this criticism, saying, through its statistician and in the report presenting the figures: "This assignment makes no deduction of stocks and bonds owned by railways in their corporate capacity, and, to the extent that such deductions are proper, overstates the capital."

capitalization for every one hundred dollars sustained by the railways of this country. Even Canada, with its system of approximately 20,000 miles of railway, largely built with the aid of credit loaned by the Government, shows an average capitalization of over $60,000 per mile, or nearly twenty per cent higher than the United States.

A TOTAL OF INCONGRUOUS ITEMS

The capitalization representing American railways consists of securities of many different grades, each grade making its claim for annual returns to its owners with separate force and having its own degree of power or lack of power to enforce its demands. The highest grade of security consists of mortgage bonds which carry the right to a definite income with the property itself pledged against default. Other funded debt includes bonds based upon income which involve no lien upon the property and equipment trust obligations, secured by liens upon rolling stock. The volume of each of the different classes of capital issues and its proportion to the mileage and to the aggregate capitalization are as follows:

Class.	Total.	Per mile of line.	Per cent of total capitalization.
Mortgage bonds	$5,456,349,002	$25,142	48.86
Income bonds	253,707,699	1,169	2.27
Equipment Trust obligations	186,302,906	859	1.67
Miscellaneous obligations	786,241,442	3,623	7.04
Shares of stock	4,484,504,943	20,664	40.16
Total	$11,167,105,992	$51,457	100.00

Actually, there is something quite ridiculous in the effort to combine these incongruous items in a single aggregate. It is possible to add three elephants, eight cows,

seven mice and a guinea pig and say that the total is nineteen animals but the aggregate is not very enlightening and scarcely repays the effort. The items which make up the aggregate railway capitalization are not less incongruous. There are included in the aggregate usually given no less than $582,492,783, in par value, of bonds which regularly pay six per cent or more per annum and with them, also at their par value, $2,435,470,337 of stock on which nothing has been paid for a decade. Ten shares of the Union Pacific Railway paying their owner $100 yearly and worth in the market at present prices about $1,350, ten shares of the Chicago Great Western Railway common which have never paid their owner anything and can be bought in the market for less than $125, ten shares of the Delaware, Lackawanna and Western which have paid $710.00 to their owners within five years and can be sold any day for about $4,500, ten shares of Pere Marquette Railway which represent a property now insolvent and in the hands of a receiver, a $1,000 mortgage bond of the Chicago and North Western Railway bearing seven per cent interest per annum, and a $1,000 Lake Shore collateral bond of the New York Central bearing 3½ per cent annual interest, all have the same par value. Add these par values together and you get a total par value of $6,000. What is such a figure worth for any purpose worthy of an intelligent man? Yet that is the way that aggregate capitalization is ascertained.

REAL VALUE EXCEEDS PAR VALUE OF CAPITALIZATION

Nevertheless public opinion does attach some importance to this aggregate of incongruous items and due respect for that opinion suggests further scrutiny of the con-

clusions which it seems to many to support. It is alleged that capitalization is far in excess of the actual cost of rights of way, construction and equipment and that this fact in some way enables the railways to exact excessive charges for their services.† That American railways are not capitalized as highly as European railways has already been shown. Is the American rate of capitalization, however, excessive when compared with original cost or present value? The question of railway values was recently made the subject of an exhaustive investigation by the Census Bureau and although the methods of inquiry followed are by no means above criticism the fact that the value on June 30, 1904, was placed at $11,244,852,000, or 4.98 per cent more than the total capitalization on that date is significant.

COST OF EARLY STRUGGLES

Experience during every decade of American railway development, prior to the last, proved the construction of new railways to be an extremely hazardous enterprise. This was particularly true during the two speculative decades following the Civil War, when railway lines were pushed ahead of population and industry and millions were lost because there was then too little traffic to justify the capital expenditure on properties that have since become useful and necessary parts of the Nation's system of transportation. Under such circumstances, heavy discounts upon the commercial paper issued to secure capital were inevitable and the boldness with which this

†A typical argument in support of these charges is to be found in the article entitled "Capitalization of Railway Corporations," by Honorable Wharton Barker, in the "North American Review" for October, 1906.

condition was accepted was characteristic of men courageous enough to adventure their time, capital and reputations in these undertakings. Actual cash capital was represented by bonds which were, sometimes, sold below par and often accompanied by bonuses in stock. The daring spirits who induced the investments and actually conducted the work of construction took their chances of profit in stock for which they paid only in tireless energy, prophetic imagination, irresistible determination and transcendent courage. The times controlled their methods and their methods were suited to their times. Many of them never realized any profits for themselves, and millions of cash which their enthusiasm attracted were absolutely lost by the investors. As a result the United States entered the decade of the '80s with a railway system which was, in its adaptation to the needs of the trade and commerce of the people, far in advance of that possessed by any other nation. But this system was capitalized at, probably, somewhere near double what its physical reproduction would have cost although at considerably less than the actual expenditure upon it. The end of stock-watering was, however, then plainly in sight.

NO INCREASE PER MILE SINCE 1880

Since 1880 there has been no increase in the average capitalization per mile of American railways, as is shown by the following table:

Year.	Capitalization per mile of line. Funded debt.	Stock.	Total.
1880	$25,400	$27,700	$53,100
1890	26,975	22,498	49,473
1895	28,767	22,539	51,306
1900	27,680	23,413	51,093
1905	30,793	20,664	51,457

The methods of financing railway enterprises which prevailed prior to 1880 have passed away, railway paper is no longer heavily discounted and for two decades railway corporations have been busily engaged in recreating their properties. The latter process has now gone so far that there is no longer a dollar of water in the aggregate railway capitalization and the American railway system could not now be reproduced even for a sum much greater than the total par value of all the bonds and stock by which it is represented.

PRESIDENT HADLEY'S VIEW

This is the view of President Hadley, of Yale University, who declared some two years ago that:

> "Taking the railroads of the United States as we see them, I am confident that it would be quite out of the question to duplicate them for an average of $50,000 a mile; and this figure applied to the whole system would represent a legitimate cost of at least $10,300,000,000."

The increase in mileage since President Hadley wrote the foregoing would raise his aggregate to more than $11,000,000,000.

RE-INVESTING RECEIPTS FROM SERVICES PERFORMED

Some of the progress in the improvement of railway facilities which has been accomplished without increasing the average capitalization are statistically traceable, at least for a part of the period during which such progress has been most rapid. Thus since 1880 iron track has practically disappeared and steel track of twice the weight of the iron which it replaced has been substituted. The following shows the rapidity of the change:

Year.	Length of all tracks in miles.	Track composed of steel rails. Miles.	Per cent of total.
1880	115,647	33,680	29.12
1885	160,597	98,102	61.09
1890	208,303	167,606	80.46
1895	235,198	206,546	87.82
1900	257,853	238,464	92.48
1905	301,332	290,529	96.41

While the substitution shown by the foregoing has been in progress routes have been straightened, the radii of curves lengthened and grades reduced, many companies going so far as to relocate long stretches of track and even whole divisions. Efficiency and quality have been also augmented, by noteworthy additions to supplemental trackage. This progress is shown by the following table:

YEAR	TOTAL LENGTH OF LINE IN MILES*	TOTAL LENGTH OF ALL TRACKS**		TOTAL LENGTH OF YARD AND SIDE TRACKS	
		Miles	Per 1000 Miles of Line	Miles	Per 1000 Miles of Line
1890	163,596	208,613	1,275	35,255	215
1895	177,746	233,276	1,312	43,181	243
1900	192,556	258,784	1,344	52,153	271
1905	216,974	306,797	1,414	69,943	322

YEAR	TOTAL LENGTH OF SECOND TRACKS		TOTAL LENGTH OF THIRD TRACKS		TOTAL LENGTH OF FOURTH TRACKS	
	Miles	Per 1000 Miles of Line	Miles	Per 1000 Miles of Line	Miles	Per 1000 Miles of Line
1890	8,438	52	761	5	562	3
1895	10,640	60	975	5	733	4
1900	12,151	63	1,094	6	829	4
1905	17,056	79	1,610	7	1,216	6

*Exclusive of mileage (less than one per cent. of the actual total) not reporting to the Interstate Commerce Commission.

**The figures in this column are those of the Interstate Commerce Commission and differ slightly from those in the next previous table which are from Poor's Manual of Railways for 1906.

Thus, in fifteen years the proportion of supplemental trackage in general has increased 50.55 per cent, that of yard and sidetracks 49.77 per cent, and that of second track 51.92 per cent.

BETTER EQUIPMENT AND MORE OF IT

The equipment represented by capitalization also averages higher numerically and in capacity and quality than it did in 1890. Thus there were 223 locomotives per 1,000 miles of line in 1905 as against 190 in 1890, an increase of 17.37 per cent. Other relative increases are shown below:

Locomotive equipment per 1,000 miles of line.

Year.	Total.	Passenger.	Freight.	Switching.
1890	190	50	100	..
1895	201	56	113	29
1900	195	51	112	29
1905	223	54	128	37

Car equipment per 1,000 miles of line.

Year.	Unclassified.	Total.	Passenger service.	Freight service.	Company's service.
1890	..	7,480	170	5,870	...
1895	3	7,148	186	6,729	233
1900	3	7,535	180	7,092	263
1905	4	8,494	188	7,980	326

The improvement in the quality of equipment for passenger service is known to everyone who remembers the discomforts of railway travel in the '80s or earlier. These changes cannot be stated statistically, but some of the improvements in rolling stock are subject to such treatment.

INCREASED USE OF SAFETY APPLIANCES

The recent extension of the use of safety appliances is shown in the following table:

Equipment with safety appliances.

Year.	Total. cars and locomotives.	Fitted with train brake. Number.	Per cent of total.	Fitted with automatic coupler. Number.	Per cent of total.
1890	1,199,807	148,827	12.40	115,319	9.61
1895	1,306,260	362,498	27.75	408,856	31.30
1900	1,488,501	1,005,729	67.57	1,404,132	94.33
1905	1,891,228	1,641,395	86.79	1,871,590	98.96

LARGER FREIGHT CARS AND MORE OF THEM

Data concerning the increased size of cars and the augmented tractive power of locomotives have only recently become available. Those which cover the limited period of the last three years illustrate, however, the rapidity of a movement which, as is well known, has been in progress for more than a decade. The following figures show the number of freight cars above and below thirty tons capacity in 1902 and 1905, respectively, with their aggregate capacity in tons and the rates of increase or decrease in the three years:

Item.	1902.	1905.	Per cent increase or decrease in three years. Inc.	Dec.
Freight cars of less than 30 tons capacity:				
Number	641,116	532,450	....	16.95
Aggregate capacity in tons	13,640,816	11,553,209	....	15.30
Average capacity in tons	21.28	21.70	1.97	....
Freight cars of 30 tons capacity or more:				
Number	864,876	1,195,170	38.19	....
Aggregate capacity in tons	28,652,161	41,701,874	45.55	....
Average capacity in tons	33.13	34.89	5.31	....
All freight cars:				
Number	1,505,992	1,727,620	14.72	....
Aggregate capacity in tons	42,292,977	53,255,083	25.92	....
Average capacity in tons	28.08	30.83	9.79	....

MORE MOTIVE POWER

During the same period there has been an equally significant increase in the size and power of locomotives, as shown by the following:

Number.

Class.	1902.	1905.	Per cent increase in three years.
Single expansion	35,288	45,033	17.83
Four-cylinder compound	1,175	1,793	52.60
Two-cylinder compound	1,113	870	Decrease.

Average tractive power in pounds.

Class.	1902.	1905.	Per cent increase in three years.
Single expansion	19,946	23,178	16.20
Four-cylinder compound	29,031	32,326	11.35
Two-cylinder compound	28,515	31,056	8.91

During the same three-year period the total tractive power of the locomotives shown in the above table increased from 768,502,779 to 1,128,771,082 pounds, or 46.88 per cent.

TRAINS AND TRACKS DO MORE WORK

The changes shown and suggested, all of which it is to be remembered have improved the quality of railway facilities and added to the value of railway property without adding to the average capitalization, have vastly increased the efficiency of the average mile of line and of the average train as mechanisms for moving traffic. The extent of this is indicated by the following data:

Year.	Number of tons of freight carried one mile per mile of line.	Number of tons of freight carried one mile per mile run by freight trains.
1870	268,694	82
1880	465,732	135
1890	487,245	175
1900	735,366	271
1905	861,396	322

The foregoing shows that each mile of railway did 84.96 per cent more work and each freight train 138.52 per cent more work in 1905 than in 1880. It seems so self-evident as to need no argument that a machine capable of doing twice as much work as another is worth a great deal more. The railway machine was capitalized at more than it was worth (but not more than it had cost) in 1880; it is now worth more than the figure at which it is capitalized.

THE PENNSYLVANIA RAILROAD SYSTEM: AN EXAMPLE

If it were possible to obtain complete statistics concerning the vast expenditures made within the last decade for the betterment of the great railway systems of the country the facts disclosed would amaze those who are inclined to accept the current charges of "over-capitalization." Figures recently published showing the combined expenditures of the eleven operating companies of the Pennsylvania Railroad system during the period of six and one-half years that ended with June 30, 1906, show a total outlay actually exceeding the total par values of all the stocks outstanding against the system. The totals, so large as to amaze even those who have been fairly well informed concerning what was in progress, appear below:

PENNSYLVANIA RAILROAD SYSTEM.

Purpose.	Expenditures for the purposes named during six and one-half years.
Real estate purchases	$62,703,367.22
Renewal of way, yards, terminals and buildings	160,720,289.63
New construction	268,773,763.60
Locomotives built and rebuilt	60,551,481.49
Freight cars built and rebuilt	124,841,318.94
Passenger cars built and rebuilt	10,413,746.40
Total	$688,003,977.28

Therefore, if it be assumed that of all the property of the Pennsylvania Railroad system as it existed seven years ago there is nothing of value now remaining it must be admitted that there is now, in that system, over $650,000,000 of actual value. How does this compare with present capitalization? In the aggregate, the eleven companies which made the foregoing expenditures have outstanding, in par value, $485,917,321.44 in stock and $393,055,884.12 in bonds, making a total of $878,973,205.56. But they own shares and bonds of railroad and other corporations which have cost, in the aggregate $375,789,988.46, and would sell for more than that in the market. Deducting for this duplication, the net capitalization dependent upon and deriving its income from the property on which, as shown above, $688,003,977.28 has been expended in less than seven years is $503,183,217.10. Thus the expenditures on the property from January 1, 1900, to June 30, 1906, amount to 36.73 per cent more than the capitalization, or $1,367.30 for each $1,000 of stocks and bonds, or, if it be considered that these data would be more illuminating in another form, the actual expenditures, during the same six and one-half years, for stocks and bonds of other corporations may be added to those on the property itself, with the following result:

Expenditures for maintaining, extending and improving the road and equipment	$688,003,977.28
Expenditures for purchase of stocks and bonds of other corporations	203,424,146.46
Total	$891,428,123.74

Which shows an actual expenditure, since January 1, 1900, for property owned, that is 1.42 per cent in excess

of the total capitalization leaving all that remains of property owned prior to that date utterly out of consideration. If similar data showing recent expenditures upon the New York Central, Erie, Lehigh Valley, New Haven and Hartford, Southern, Burlington, Southern Pacific, Union Pacific,* Baltimore and Ohio and other great systems were available they would without doubt show results of kindred character. The former president of the Wabash Railroad testified in 1905 that sixty miles of then recent construction under his own direction had cost, in cash, including rights of way and terminals, over $400,000 per mile.

PAR VALUES CANNOT AFFECT RATES

If, however, it were true that "over-capitalization" does exist, to the full extent of the wildest charge of the noisiest anti-corporation agitator, the fact would be of no injury and of no consequence to the purchaser of railway services. The persistence of the erroneous notion that there is some occult force in par values which makes their inflation an easy means of extorting excessive rates from the shipping and traveling public is one of the strangest of phenomena in the whole history of popular delusions. More than twenty years ago, in the ablest general work on railway economics ever produced in the United States, President Hadley, of Yale University, wrote:

*A recent statement shows that under the administration of Mr. E. H. Harriman the Union Pacific Railway Company has expended $109,157,655 for betterments, changes in line, new equipment, new lines and new or improved terminals, and $225,000,000 for purchase of securities. This is 67.29 per cent of its outstanding capitalization, which aggregates $496,561,080. See article by Daniel T. Pierce in the May, 1907, issue of The Inter-Nation.

"It is now pretty well understood that fixed charges do not directly affect rates; nor do dividends affect them, except in so far as a road which is paying very high dividends may reduce rates lower than it otherwise would, in order not to tempt new capital into the field."

Of course, everyone understands that fixed charges and dividends express the effective demand of capital for a fair return and that if they do not affect rates, to the injury of shippers and travelers, there is no other way in which capitalization can operate upon rates. Speaking with knowledge gained during many years devoted to the problems of rate regulation, Honorable Martin A. Knapp, chairman of the Interstate Commerce Commission, testified before the Industrial Commission, as follows:

"I have not seen any instances in which the rates have seemed to much depend upon or be influenced by the capitalization of a road . . . . The capitalization of the railroad, I think, cuts no figure in this rate question."

AN ACCUSATION ANSWERED BY FACTS

The facts, however, are so readily discoverable that no man's authority need be accepted. Unimpeachable and direct evidence is available to anyone who seeks the truth. Let the charge and the facts be examined together. In the Senate of the United States, in June, 1906, Senator LaFollette expressed the crude but popular belief, as follows:

"They clearly understand that every dollar of over-capitalization imposes an extra charge to be paid on every hundredweight and every ton of traffic transported . . . . In the purchase of $108,000,000 of securities of the Burlington by the Great Northern and the Northern Pacific companies $216,000,000 of new 4 per cent bonds were issued. In the recapitalization of the Rock Island $75,000,000 of Rock Island stock was converted into $75,000,000 of bonds and $137,000,000 of new stock. The Chicago and Alton was capitalized at $30,000,000; when turned over to the purchasing syndicate in 1899 it was capitalized at $94,000,000."

It would have been highly creditable to Senator LaFollette had he examined the records and reported just what observable influence these changes in capitalization had upon the rates. Since he failed to do so, it will be done for him. The five companies which he named, with their average freight rates in 1895, 1900 and 1905 per ton per mile, appear below:

	Average freight rates per ton per mile in mills.			Decrease, per cent.	
Railway.	1895.	1900.	1905.	From 1895 to 1905.	From 1900 to 1905.
Chicago & Alton	9.94	7.94	6.89	30.68	13.22
Burlington	9.03	8.77	8.35	7.53	4.79
Northern Pacific	11.09	9.88	8.32	24.98	15.80
Great Northern	10.14	9.66	7.83	22.78	18.94
Rock Island	10.84	9.87	9.31	14.11	5.67

Thus, so far from substantiating his charge, the very railways which Senator LaFollette named supply evidence that effectually refutes the theory which he advocates. In a period in which the dollar received for their services has been rapidly diminishing in its power to purchase labor and materials the freight rates of every one of these companies have been going downward.

MORE PROOF FROM OFFICIAL RECORDS

If more comprehensive proof that there is no such relation as is alleged between capitalization and rates is desired it is at hand. The statistics published by the Interstate Commerce Commission permit the separation of the data supplied into totals each representing one of three great territorial divisions of the United States. Results of such a segregation of the statistics are shown below: